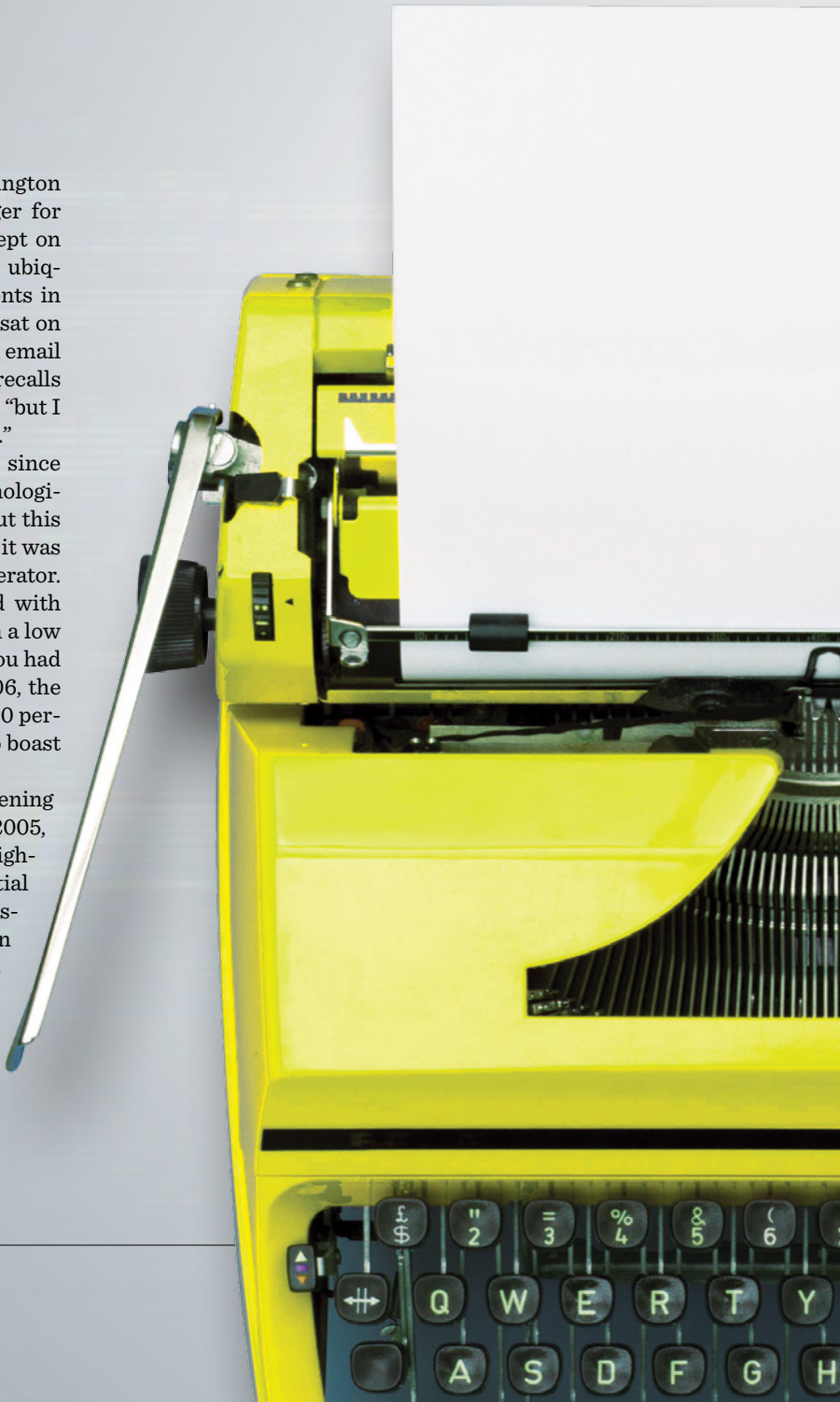
LEAPFROGGING

Washington Federal has quietly transformed itself over the past dozen years from a technologically antiquated thrift



When Brent Beardall joined Washington Federal as controller in 2001, the ledger for the bank's holding company was still kept on those big green paper tablets that were ubiquitous throughout accounting departments in a bygone era. Employees communicated by fax. A typewriter sat on every desk. The bank didn't even give its executives individual email accounts. "I was in charge of the bank's investment portfolio," recalls Beardall, who was promoted to chief executive officer in 2017, "but I had to execute trades using my personal Yahoo! email account."

Every executive who has worked at Washington Federal since before the financial crisis has a story to tell about how technologically antiquated the now $16.4 billion bank was back then. But this approach to technology was not a product of neglect. Instead, it was a byproduct of an intentional strategy to be a low-cost operator. Washington Federal's culture of pinching pennies, directed with equal vigor at expenses and investments, translated into such a low efficiency ratio that, like a unicorn jumping over a rainbow, you had to see it to believe it. In all but three years from 1992 to 2006, the bank based in the heart of downtown Seattle spent less than 20 percent of its revenue on operating expenses, earning the right to boast that it was the most efficient bank in the industry.

Much has changed at Washington Federal in the intervening years—especially when it comes to technology. As late as 2005, Beardall's predecessor, Roy Whitehead, touted the bank's "high-touch, low-tech" business model focused on making residential home loans funded by savings accounts and certificates of deposit. This is no longer the case. Today, executives at Washington Federal are ardent evangelists of digital banking. The bank's vision of the future, laid out by Beardall at the bank's annual shareholder's meeting this year, is to be a "highly-profitable, digital-first bank that leverages data to anticipate financial needs and empower our clients by creating frictionless experiences across all interactions and devices."

How did a bank that didn't offer internet banking until a decade ago come so far, so fast? This is a natural question to ask. But what if, instead of hindering Washington Federal's

BY **JOHN J. MAXFIELD**

INTO THE FUTURE

into a full-fledged commercial bank on the vanguard of the digital revolution.



progress, its long-time repudiation of technology actually worked in its favor? That's how executives at the bank see it. "The task of getting rid of the technology we had was not as big of a lift as it might be for [other banks] where they've spent years building out their platforms," says Cathy Cooper, executive vice president and retail banking group manager. "Operationally, it's really hard to move that ship."

Making the leap from one technological era to the next is hard for any company in any industry, but if Washington Federal's illustrious past is any indication, one would be excused for thinking it is up to the challenge. "One of Washington Federal's strengths is its adaptability," says Jacquelynne Bohlen, equity research analyst at Keefe, Bruyette & Woods.

Washington Federal has come a long way since its founding in 1917 as a savings and loan focused on the fishing and milling communities of Ballard, Washington, a northern suburb of Seattle. It operates 235 branches throughout an eight-state footprint, arching from Washington down to Texas. It is the biggest bank based in its home state, a title it assumed after the 2008 failure of Washington Mutual. And based on the performance of Washington Federal through its 102-year history, most notably the exceptional value it has created for shareholders, a compelling case can be made that it is one of the preeminent financial institutions in the western United States.

Throughout much of its history, Washington Federal's success lay in its hyper-disciplined approach to minimizing costs. Its efficiency ratio the year Beardall joined the bank was 19.4 percent—less than a third of the industry average that year. Even today, the chief financial officer reviews every invoice submitted by employees. They want employees to think like owners—to treat the company's money as if it was their own. A former CFO once asked a banker about an invoice he submitted for dinner with a client, Beardall recalls. The banker had ordered an expensive bottle of cognac. "What in the world are you doing? A bottle of cognac?" asked the CFO. "In all due respect, I was treating the company's money as if it were my own," the banker responded. "That's what I drink."

The results speak for themselves. It was not unheard of for

Washington Federal's quarterly return on assets throughout the 1980s to eclipse 3 percent. Today, many banks are happy to earn 1 percent on their assets. Even as late as the mid-2000s, long after the sun had set on savings and loans, Washington Federal intermittently earned 2 percent on its assets, the gold standard in the industry. And Washington Federal catalyzed its profitability with acquisitions. It has completed 17 acquisitions since going public in 1982, not including the purchase of 74 branches from Bank of America Corp. in 2013. This combination of growth and profitability has yielded extraordinary results for shareholders. Washington Federal's stock has generated a total return (dividends plus share price appreciation) of nearly 12,000 percent since its public debut 37 years ago. That ranks sixth among publicly traded banks over this time period based on total shareholder return.

"To avoid being locked in for the long term to a particular platform or type of technology is important if we're going to survive this disruptive period, where T-Mobile is starting a checking account and Amazon has thousands of people working on their finance application."

— **Cathy Cooper,** executive vice president and retail banking group manager

Another secret to Washington Federal's success through the years is that it focused on doing very few things but doing them well. As late as 2007, upwards of 95 percent of its loan portfolio consisted of loans to finance the construction or purchase of residential homes. Washington Federal never got into the securitization fad. It did not begin to aggressively market checking accounts until well into the new millennia. "All those complexities add all kinds of costs," Beardall explains. Whitehead, who served as CEO from 2000 until 2017, likened it to doing a simple pike dive in swimming, Cooper recalls. "We were not doing anything fancy, but we were going to do it perfectly," she says.

But a little over a decade ago Whitehead concluded that Washington Federal needed to change course. "Somewhere around 2006, Roy came to the understanding that, as long-term secular rates came down, being a lend-long, borrow-short bank was going to be problematic if rates ever came back up again," Cooper says. "His premise was that we needed to diversify from the thrift model to more of a commercial bank model, and he was going to help us do it." It was a prescient plan that would leave an indelible imprint on the bank.

Starting in 2007, Washington Federal began building up the commercial side of its business by acquiring community banks with the requisite expertise—one in New Mexico and one the following year in neighboring Bellevue, Washington. That same year, it hired a chief credit officer with commercial banking experience, Mark Schoonover, who was tasked with helping the bank convert from an asset-based lender to a cash-flow lender. To support this transition, however, the bank needed to modernize its technology infrastructure. It had to be able to support more checking accounts and provide a platform for making larger and more nuanced loans. So in 2008, the bank announced Project Tritan, a multi-year effort to rewrite its technology core, which it had built and operated on its own since 1972.

The technology conversion was bittersweet. Although the updated core supported Washington Federal's burgeoning commercial operations and enabled it to finally begin offering internet banking in 2009, the improvements came at a cost. "Historically, a low-cost IT infrastructure has been the 'secret sauce' in our recipe for efficiency," Whitehead wrote in his 2008 shareholder letter. By keeping the function in-house, Washington Federal was able to hold its IT costs to less than 15 percent of the industry average, saving millions of dollars a year. Project Tritan changed this. It was expected to double the bank's IT expense, "yet the additional cost is necessary to obtain the critical security, operational and information requirements necessary to manage a company our size and larger in the modern age," Whitehead wrote.

Project Tritan was just the beginning. Within three years of its completion, Washington Federal set off on an even more ambitious overhaul of its legacy system—a Tandem Computers' system still running on the COBOL programming language. "It was an unbelievable mainframe," Beardall says. "It just ran and ran and ran and ran. But literally no one knew the programming language. We said, 'We can't continue to invest in this. We need to get modern architecture.'" So Washington Federal bit the bullet in 2013 and decided to outsource its technology core. It was a three-year program called Project Catalyst, designed to move Washington Federal from its stable and cost-efficient but inflexible legacy operating system to a more modern, efficient and scalable system provided by Fiserv. As Whitehead saw it, the new system would increase IT expenses even further but provide competitive advantages in customer experience, speed to market and improved reporting.

"There's a lot of pain when you go through con-



versions," Schoonover says. "You can do it either gradually or by ripping the Band-Aid off and do 30-some systems all brand new, all at once. That's what we did." The alternative is "to do your core, get it tweaked right, then add in an origination system [and all the other systems, one at a correct to time]," he continues. "It takes longer to do that, and by the time you get to the end of the 29th system that you've bolted on your core is old again. It's sort of like painting the Golden Gate Bridge—as soon as you get done, you have to start painting again. So we decided to just rip the bandage off."

The completion of Project Catalyst in 2016, and Beardall's promotion to CEO the next year, marked the culmination of Washington Federal's technology conversion, as well as its evolution from a thrift to a commercial bank. In Beardall's first year, commercial loans accounted for 67 percent of the bank's total loan production and 43 percent of net loans outstanding. Only 11 percent of its customers' transactions occurred at a physical branch that year, while 89 percent of transactions happened through mobile banking, online banking, ATMs or other automated processes. The downside is that its efficiency ratio has more than doubled, to 50 percent—though, remarkably, that remains meaningfully below the current industry average of 57 percent.

As Beardall and his team see it, the digital transformation of banking has triggered a shift in the industry's competitive dynamics. "Competitiveness in the banking industry has changed over time," Cooper says. In the 1950s and 1960s, it was about branches, Cooper notes—how many a bank had, how big they were, where they were located, how many drive-thru lanes each branch had. In the 1980s, as interest rates climbed following the oil crises of the prior decade, competition in banking shifted to rates and fees. That was the era of the free checking account. That was also when banks, freed up by deregulation, began competing more aggressively on CD rates. Then starting at some point in the last decade, Cooper says, "is this idea that you can differentiate yourself competitively if you start to advocate for your client's financial health."

It is no longer enough for a bank to simply provide a source of capital and a safe place for people to store their money, Cooper believes. Customers who have grown up with smartphones and mobile applications expect more. They are looking to technology to not just provide services but to qualitatively enhance their lives. "So you see a lot now around, 'What's your credit score? What's your financial wellness score? Let's do a financial check,'" Cooper says. "Let's figure out how to make you stronger this year than you were last year, increase your net worth or whatever it is. So I've been tying that back to our original mission as a savings and loan. ... We take the money from our depositors, lend it out, help people build homes they can afford, save for the future and build a strong business."

Washington Federal does not see itself as a company of software developers that is creating these solutions itself. "We don't want to be on the bleeding edge. We're not going to be the ones out there inventing technology," Beardall says. "We want to find people that have it, partner with them and be implementers of it. That's where we want to be. And to do it fast and do it reliably."

This approach takes a cue from computer hardware companies, notes Donald MacDonald, chief marketing officer of MX Technologies, a Utah-based company helping banks collect, enrich, present and act on their data. "Why would you build your own solutions when you can buy them?" MacDonald asks. Computer companies—even Apple—outsource

"We don't want to be on the bleeding edge. We're not going to be the ones out there inventing technology. We want to find people that have it, partner with them and be implementers of it. That's where we want to be. And to do it fast and do it reliably."

— Brent Beardall,
president and chief executive officer



> "We want to think of ourselves as a technology company that just happens to work in the banking industry, rather than a bank."
>
> — **Cathy Cooper,**
> executive vice president and retail banking group manager

the fabrication of component parts to third-party vendors. The competitive advantage lies instead, MacDonald says, in how companies configure these components into a product that delights the customer. These similarities are not lost on Washington Federal. "We want to think of ourselves as a technology company that just happens to work in the banking industry, rather than a bank," Cooper says.

Washington Federal's opportunity lies instead in integration, its executives believe, which will enable it to nimbly go in whatever direction the industry moves in. "This idea came about that we would be good integrators so that we could sort of plug and unplug whoever was coming up with the best solution, because there's a lot of disruption right now," Cooper says. The strategy pivots around a middle layer of software, or middleware, sitting between the bank's existing technology infrastructure and third-party applications, such as a new loan origination system. Right now, each new third-party application implemented by the bank requires a separate connection to the bank's other legacy applications. Cooper refers to this as a spaghetti chart. The added layer of middleware Washington Federal is building will simplify this; each new application will only need to be connected to that layer, which will then provide the connections to all the others.

Another aspect of Washington Federal's integration-focused strategy involves how it structures relationships with fintech companies. "We've had some vendors come to us and say, 'It's time to renew. We want you to sign for seven years,'" Cooper says. "We're like, 'That's an insanely long amount of time.' As a matter of fact, my digital channels guy was just in here and said, 'Anything more than three years feels like forever.'" Cooper describes this as being vendor agnostic. "To avoid being locked in for the long term to a particular platform or type of technology is important if we're going to survive this disruptive period, where T-Mobile is starting a checking account and Amazon has thousands of people working on their finance application."

But the thing Washington Federal is most excited about is data. "In today's day and age, data is everything," Beardall says. Banks have better data than even Facebook, Amazon and Google, he notes. "We know where you work. We know how much you get paid. We know where you shop. We know where you're going on vacation." Beardall is not suggesting that banks monetize this data with ads. "I'm suggesting we use this to help you as our client," Beardall says. He points to a number of potential applications. For example, data would make it easy for a bank to identify customers with multiple Apple Music accounts. The bank could then reach out to those customers and, if the customers so desired, it could even close the redundant accounts on their behalf. Another way data could be leveraged would be to provide tailored credit card spending authorizations to different members of a family.

"Historically our recipe for success—I put this in my shareholder letter last year—has been relationships and the strength of our balance sheet," Beardall says. "This recipe has served us very, very well. We're not going to go away from either of those. But if we can add technology that makes you go, 'Wow, that was easy,' we win. We absolutely can take market share, because the big banks can't have those relationships, or they choose not to. That's the competitive advantage."

On the surface, Washington Federal's story seems similar to that of any other bank that is charting a new course in the digital age. But such a comparison ignores the comprehensiveness of the changes underway at one of the oldest and most successful banks in the Pacific Northwest. The pace and thoroughness of its transformation from a technologically antiquated monoline thrift into a technologically advanced full-fledged commercial bank combine to offer few, if any, precedents. "We like to say we are leapfrogging," Cooper says. "We were really trying to figure out how do we, not just catch up, but get in front." **|BD|**

John J. Maxfield is executive editor of Bank Director.